SOCIAL REFORM PROGRAM

(CO-0252)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Colombia	
Executing agency:	Department of Planning (DNP)	
Amount and source:	Sector loan (OC, fast disbursing):	US$390 million
	Total, sector loan:	US$390 million
Financial terms and conditions:	Amortization period:	20 years
	Grace period:	5 years
	Disbursement period:	24 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%

Objectives: The general objective of the program is to improve the impact and effectiveness of social spending by ensuring the soundness and sustainability of investments and reducing the adverse effect of economic crises. Its specific objectives are to: (i) establish countercyclical, transparent systems to finance targeted social welfare programs that will address the increase in poverty during times of economic crisis; (ii) strengthen and increase the transparency of targeting for social spending; (iii) improve the efficiency of social spending; and (iv) reduce non-salary labor costs and create incentives for job creation.

Description: The program will be carried out through two operations: a sector loan and a technical-cooperation loan. The sector loan consists of a program based on the adoption of policy measures supported by a sector loan to be disbursed in three tranches. Sector loan disbursements will be subject to fulfillment of the policy measures and goals agreed upon by the Bank and the country. These activities are summarized in the attached policy matrix (Annex 1).

The sector loan will be disbursed in the following three tranches: a first tranche in the amount of US$175 million, the conditions for release of which will be fulfilled by date the proposal is presented to the Board, a second tranche for US$155 million, and a floating tranche for US$60 million. Since the issue is self-contained, the floating tranche will be independent of the conditionalities for the second tranche, which is fixed. This sector project will consist of five components:

The first component of the program will support macroeconomic stability. For the first two tranches, Colombia must continue to comply with the guidelines set forth in the Policy Letter and Contingency Agreement signed with the International Monetary Fund (IMF) for the period 2000-2002.

Under the second component, the legal, institutional, and operational foundations will be laid to establish a financial fund to mitigate the impact of macroeconomic crises on the poorest segments of the population. This instrument will collect resources during periods of economic growth so that they can be used, according to clear, transparent rules, for programs targeting the most vulnerable segments of the population to address the increase in poverty during crises.

The third component will improve the precision and transparency of the instrument used for targeting individuals, the beneficiary identification system (SISBEN) and will ensure its use at the subnational level and in the selection of beneficiaries for national social welfare programs. Under this component, a more transparent, reliable instrument is expected to be generated and social spending to be better targeted to the poorest, most vulnerable groups. Specifically, the project will emphasize three areas to strengthen the SISBEN: (i) adjustment and fine-tuning of the point system through updating of the algorithm used; (ii) design and implementation of a quality control system for SISBEN use to minimize screening and exclusion errors; and (iii) greater use of SISBEN for beneficiary selection in various social programs, and extension of SISBEN coverage in terms of the number of people added through the strengthening of local capacity to administer and manage the system.

The activities of the fourth component are designed to improve the efficiency of social spending. The expected result of the component is more effective social spending to maintain and improve the welfare of the poor and vulnerable during periods of both crisis and more stability. Activities will be carried out in health care (extension of insurance coverage, increase in vaccination rate), education, reorganization of teaching staff to improve the efficiency and quality of the education system, regulation of the transition towards capitation of fiscal transfers in education and the information system) and vulnerable population groups (decentralization of the Colombian Family Welfare Agency—ICBF, institutional reforms and adjustments in other programs targeting vulnerable groups).

The fifth component will improve the capacity of the labor market to adapt to changing economic conditions, due to economic cycles and changes in the job skills needed on the market. The expected result is a reduction in non-salary labor costs and consequently a decrease in informal employment and in structural unemployment.

The second operation consists of a three-year technical-cooperation loan (CO-0261) to support the design and implementation of the reforms necessary to ensure that the program objectives can be achieved. The plan of operations for the proposed technical-cooperation loan is attached hereto as Annex 3. The second operation will finance an evaluation of the medium-term impact of the policies established under the Social Reform Program.

The Bank's country and sector strategy:

The proposed operation will support the Bank's country strategy and will supplement previously made investments. The current country paper for Colombia (document GN-2052-1) was approved in August 1999. It identifies five priority areas: (i) support the peace process and its sustainability; (ii) reduce poverty and inequality; (iii) achieve further decentralization; (iv) modernize the State; and (v) support sustainable growth. The proposed operation would contribute to objective (ii). Moreover, by organizing a social protection system that is financially sustainable, more effective in covering the needs of the population, and more efficient in the use of resources and coordinated with national and subnational programs, the program will also contribute to achieving objectives (iii) and (iv). Furthermore, protecting investment in human capital and making the labor system more flexible will enhance the economic growth potential of the country, thereby supporting objective (v). And through its support for the needy, the program will indirectly help achieve objective (i).

Environmental and social review:

The program will have a significant social impact. First of all, by ensuring financing for effective programs for social welfare and protection during economic crises, improving the quality and transparency of targeting for effective programs, and by reorganizing and increasing the efficiency of social programs, the program will help create the conditions necessary for a more effective response to structural poverty and the impact on welfare of the current crisis and any future ones. Secondly, the activities in labor will help promote formal employment and reduce unemployment and informal employment rates, especially among the segments most seriously affected by the current crisis (women and youth), thereby providing greater access to the formal social protection system. The impact will be measured in the ex post evaluation.

The proposed program will not have any adverse environmental impact, since its activities are limited to policy reform. The Committee on Environment and Social Impact considered the operation at its 13 July 2001 meeting and made recommendations that were incorporated into the project report.

Benefits: The immediate viability and long-term sustainability of social programs and the reorganized social protection system depend on public spending and central government revenues. The proposed program seeks to generate savings through the reorganization and through the development of financial instruments and to generate additional spending so that certain key programs can be extended. In fiscal terms, apart from the decline in parafiscal contributions, which will have a considerable impact on total social spending in Colombia, the additional costs associated with the program activities will be an estimated US$18.5 million annually and the savings generated, close to US$621 million a year.

Risks: **Fund capacity for savings**. A series of simulations was conducted to model the savings capacity of the Fund based on macroeconomic scenarios for central government revenue developed by the government and used by the IMF. The estimates were based on the saving rules discussed in chapter II, according to different economic growth scenarios for the period from 2003 to 2010. The exercise showed that if the growth pattern for the next eight years stays the same at it was during the period from 1988 to 1995, the Fund will accrue 1% of GDP, the best-case scenario. However, if the pattern is the same as for the period from 1985 to 1992, the Fund will accrue barely 0.2% of GDP, the worst-case scenario. The government would then only have enough resources for a one-year crisis and would have to seek other sources of financing to respond to a longer one.

Program timing. Program timing is crucial, since the difficult policy decisions associated with the program activities are usually made during period of recovery from economic crises, not during healthier fiscal times. This is an opportunity for decisions to be made that will have an immediate effect on the welfare of the target population and a mitigating impact on future shocks. Nevertheless, there is a risk that, given the current economic situation, the political cycle may create difficulties for the necessary decisions to be made. Accordingly, the respective legislation should be passed prior to the change in government and an information campaign with intensive outreach activities with the main stakeholders should be carried out. In

	addition, support for legislative initiatives that have broad-based political support will help ensure the viability of the measures proposed.
Special contractual clauses:	The contract for the sector loan will include the conditions established in the Policy Matrix (Annex 1) and will specify that the Policy Letter (Annex 2) is an integral part of the loan contract.
Procurement:	Not applicable
Social equity classification (SEQ):	This operation qualifies as a social equity enhancing project, as described in the key objective for Bank activity set forth in the Report on the Eighth General Increase in Resources (document AB-1704).
Poverty-targeted investment (PTI):	As a sector loan, this operation does not qualify as a poverty-targeted project.
Exceptions to Bank policy:	None